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Yen Rises To New Postwar High

On January 19 the yen hit its highest level since April 1949 when the Japanese currency was pegged at Y360=$1.00. The yen's renewed appreciation has alarmed Japanese government officials concerned about its deflationary effects on the economy. In a record $10.2 billion volume of trading on the Tokyo market, the yen cleared the Y150=$1.00 barrier before closing at Y150.45, breaking the previous high of Y152.55 set last August 20. The dollar's decline came despite massive intervention by the Bank of Japan estimated at between $1 billion and $2 billion. Japan's currency has risen 6.4 percent in relation to the dollar since the first of the year and 60.9 percent since the September 1985 Group of Five meeting.

Satoshi Sumita, governor of the Bank of Japan, promised to continue to intervene to promote exchange rate stability, which he said is the key to the recovery of Japan's economy. The government's FY 1987 outlook of 3.5 percent

Japan Distills Liquor Taxes

Japan and the European Community are making progress in solving a dispute over Tokyo's liquor taxes that should help put relations back on a friendlier footing. The EC, whose members have a comparative advantage in this area, has long urged Tokyo to reduce and simplify its system of commodity taxes on alcoholic beverages. As Japan's trade surplus with the community increased to $11 billion in 1985 and over $13 billion in the first nine months of 1986, the EC decided to make the issue a test of Tokyo's good will. Japanese officials then came up with a package of tax cuts and classification changes that would significantly lower the prices of imported alcoholic beverages, but the Europeans were not satisfied.

The EC, the United States and other countries have sought changes in Japan's liquor taxes for several years. Although makers of distilled alcoholic beverages were the first to support the issue, they have been joined over the years by producers of wine and beer. The principal foreign complaints are that Tokyo levies a tax on both value and quantity as well as a variable tax based on quality, and that the classification system employed discriminates against foreign products. For example, Scotch whiskey is distilled from pure malt and grain, putting it in the special category for whiskey that is taxed at over Y2,000 ($12.90 at Y155=$1.00) a liter. Many brands of domestic whiskey, on the other hand, contain alcohol blended from several sources. These are graded as second class and are taxed less than Y300 ($1.94) a liter. In light of its traditionally strong export position in alcoholic beverages, the Europeans have taken the lead on this issue.

During the last annual ministerial talks, December 11-12, Tokyo announced that it would review liquor taxes as part of its overall tax reform program (see JEI Report No. 46B, December 19, 1986). The Europeans made it clear that a partial reform would not be satisfactory and that it would indicate the lack of importance Japan attaches to the relationship. The EC leadership underscored its position by moving ahead with plans to ask for consultations under the auspices of the General Agreement on Tariffs and Trade. Such a hard-line position seemed hasty since Tokyo had not yet developed concrete proposals.

True to its word, Tokyo proposed December 24 a thorough reform of liquor taxes effective April 1, 1988. Not only will several special classifications that apply mainly to foreign products be eliminated but taxes will be reduced to one-half to one-seventh of their current levels (see Table). The plan would mean an end to taxes based on value and almost complete simplification of the quality-based levy. The Ministry of Finance hopes to phase out the remaining tax on whiskey and brandy based on the percentage of malt over a five-year period.

The Europeans welcomed the plan but said it did not go far enough. The EC Commission lamented that "Even if the proposal finally establishes a uniform fiscal regime for wines and liqueurs, it still discriminates against alcohols." The commission plans to continue with the GATT consultation process. Tokyo is hoping that the combined impact of tax reform and the strong yen will boost imports of alcoholic beverages and ease the situation. Both European and American distillers, vintners and brewers stand to gain from the changes.

Jon Choy

Proposed Liquor Tax Reform

(in yen per kiloliter)

	Typical percentage of alcohol	Current tax	Proposed tax
Sake			
Special class	15%	Y570,600	*
First class	15	279,500	Y218,500
Second class	15	107,900	67,800
Synthetic sake	15	81,500	55,100
Shochu (spirits of Japanse origin)			
Type A	25	78,600	52,100
Type B	25	50,900	21,900
Mirin (sweetened Japanese rice wine)			
Type A	13.25	74,100	40,700
Type B	22	63,500	39,400
Beer	n.a.	239,100	206,100
Fruit wine			
Pure fruit wine	n.a.	60,400	*
Other fruit wine	n.a.	49,700	20,100
Sweetened wine	12	117,3[illegible]	63,900
Whiskey and Brandy			
Special class	43	2,098,100	1,636,380**
First class	40	1,011,400	1,522,200**
Second class	37	296,200	***
Other Spirits	37	361,800	243,800
Liqueurs			
Type A	15	367,000	*
Type B	12	117,000	63,900
Miscellaneous Liquors	12	117,300	63,900

*Combined with following class
**Although special class will be combined with first class, the tax is based on different alcoholic strengths.
***Classified with Other Spirits

Source: Ministry of Finance

The Soviet overtones of the Kuranari tour were more pronounced in his comments to the Japan-Australia Ministerial Committee January 8. Mr. Kuranari warned of efforts to expand Soviet influence in the Pacific through military, economic and political means, declaring that such a concerted drive could have serious negative consequences for the stability of the region. His concern was underscored by his final stopoff in Vanuatu, which recently completed a fishing rights agreement with the Soviets.

As Mr. Kuranari was delivering his message in the Pacific, the prime minister ventured to Eastern Europe and neighboring countries, again establishing another first. While the tour demonstrated to his domestic political audience the prime minister's international leadership, it was intended to raise Japan's profile in this region and perhaps facilitate expanded contacts between Poland and members of the West, including Japan, through high-level visits by foreign officials. It was also clear that Mr. Nakasone wanted to communicate to the Soviet Union Tokyo's concerns over Asian policy proposals announced by Soviet leader Mikhail Gorbachev in Vladivostok July 28, 1986 (see JEI Report No. 29B, August 8, 1986). Finally, he sought to stimulate his planned exchange of visits with Mr. Gorbachev.

Discussions on this final point ground to a halt following the difficulties arising between the United States and the Soviet Union in the November 1986 mini-summit. At one point the possibility of Mr. Gorbachev's coming to Tokyo in January 1987 seemed realistic, but now Soviet officials are alluding vaguely to the possibility of renewing talks in the late spring.

Michael W. Chinworth

Notes

• The latest available figures on Japan's 1985 official development assistance showed a continuation of the secotral patterns established in recent years, with 43 percent of bilateral funds going to public utility projects (see Table). Agriculture and fisheries projects received the next-largest amount -- some 17 percent of total commitments. Emphasis on social infrastructure and welfare projects declined in contrast to the continued hikes that sector had seen in previous years, while education and industry, mining and construction both recorded sizable increases.

Distribution of Japan's Bilateral ODA Commitments, 1984-85*

(in millions of dollars)

	1984	1985	Percent Change 1984/85	Percent of Total 1983	Percent of Total 1984
Public utilities	$1,605.4	$1,756.6	9.4%	40.5%	43.1%
Planning and public administration	14.6	25.8	76.7	0.4	0.6
Agriculture and fisheries	497.5	699.5	40.6	12.5	17.2
Industry, mining and construction	388.7	432.1	11.2	9.8	10.6
Trade, banking, tourism and services	50.7	18.7	-63.1	1.3	0.5
Education	188.4	317.8	68.7	4.8	7.8
Health	138.8	161.9	16.6	3.5	4.0
Social infrastructure and welfare	170.2	117.7	-30.8	4.3	2.9
Multisector	88.1	98.6	11.9	2.2	2.4
Unspecified	60.8	144.6	137.8	1.5	3.6
Not allocable by sector**	764.7	302.4	-60.5	19.3	7.4
Total	3,968.0	4,075.6	2.7	100.0	100.0

*Commitment basis

**Includes commodity loans, food aid, debt relief and other types of aid.

Source: Ministry of Foreign Affairs

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The views expressed in this report are those of the authors and do not necessarily represent those of the Japan Economic Institute.